consequent capital management

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Staying the Course

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The recent sharp declines in equity markets together with the spike in volatility have raised investor concerns. In the first three weeks of October, global equity markets with only a few exceptions, lost between -6% and -10%, with some markets experiencing double digit losses. A key gauge for volatility in the U.S. stock markets, the VIX index, almost doubled in the month of October. Despite the steep losses in October, the broad domestic equity market is still up +3.5% for the year, while the broad growth index is up 8%. On the other hand, the Russell 3000 Value index is down -1.2% year-to-date. International equity markets have significantly underperformed the U.S. in 2018. In the eurozone, year- to-date losses ranged from -6% to -13% even before currency losses (versus the U.S. dollar) of -4% to - 5%. Emerging markets have also experienced steep losses in 2018 with the Chinese equity market down -28% including a 6.6% depreciation in the Chinese currency, the yuan. While the Indian stock market fared better with losses of less than 1% in local currency terms, this was swamped by the almost 15% depreciation in the Indian rupee.

There are many factors at play for the recent steep losses in global equity markets including concerns that economic growth generally and company revenues and earnings more specifically are slowing down, escalating trade tensions with China, rising interest rates in the U.S. and rising political risk in Europe related to Italy as well as the Brexit negotiations. It is, however, important to note that despite these issues, the underpinnings for a continuation of the global economic expansion remain in place. In the United States, the labor market is at its tightest level in half a century, while consumer and business confidence are at their highest levels in more than two decades. Although company revenue and earnings growth are likely to slow next year, there are few signs of an imminent downturn. Meanwhile, the recent economic stimulus measures put in place in China are likely to help counteract the negative effects from the trade tariffs with the U.S.. On the inflation front, core inflation globally remains below 2%. In some major developed markets such as the eurozone and Japan, core inflation is growing at less than 1% year-over-year. As a result, global monetary policies remain accommodative. Despite 8 interest rate hikes by the Federal Reserve, the federal funds rate is still at a low 2.25%. Even with an anticipated three to four additional rate hikes over the next year, the funds rate would likely peak around 3.25%. Over the past 30 years, prior to the last three recessions, the funds rate peaked at an average rate of 7%. The peak prior to GFC (Great Financial Crisis) was 5.25%. Additionally, the Fed's balance sheet remains over $4 trillion, compared to less than $900 billion just before GFC. Collectively, the three largest central banks (Federal Reserve, ECB and BoJ) have over $14 trillion on their balance sheets.

While the weakness in the equity markets may persist in the short term for technical reasons, we believe that the magnitude of global liquidity combined with low inflation and stimulative fiscal policies will continue to be supportive of both global economic

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growth and asset prices over the longer term.
